the contract. We sustain the objection to the offer of this telegram, and note an exception to plaintiff.

Eleventh exception. The learned court erred in sustaining defendant's objection to the question of plaintiff's counsel, and in rejecting the testimony as follows:

Plaintiff's witness, Clifton Taylor, being on the stand and having testified that, in making an investigation for the purpose of verifying the statement contained in the telegram from Jouravleff (Plaintiff's Exhibit No. 1) to the effect that Jouravleff had an interest in a Baltimore tungsten smelting plant, he learned from the president of the said company that Jouravleff had an interest in the said company, was asked the following question by plaintiff's counsel, and upon objection of defendant's counsel thereto, the following ruling was made (Transcript, pp. 41–42):

Mr. RUSLANDER:

Q. Did you ascertain in that manner whether or not the interest was worth anything in money?

Mr. BLAISDELL. I object to this as incompetent, irrelevant, and immaterial, and as not having any bearing on this case. That is objected to as immaterial.

The COURT. I can not see the materiality of this testimony, and, furthermore, we do not think it is competent to show by this witness what the president of the company inquired about may have told him with reference to the interest of the other person. If
49 you propose to show by the testimony of the proper witness, and persons familiar with that company, the relation of Jouravleff to it, there is direct evidence that you might produce, if it is competent at all; and it can not be proved by what some officer of the company may have told this witness. We sustain the objection and note an exception to the plaintiff.

Twelfth exception. The learned court erred in rejecting plaintiff's offer of evidence as follows:

Plaintiff's witness, Clifton Taylor, being on the stand, and having testified that he had in 1918 made an extensive investigation as to the ability of Jouravleff to perform his contract with plaintiff, the following offer and ruling occurred (Transcript, pp. 44–46):

Mr. RUSLANDER. Counsel for plaintiff proposes to prove by the witness on the stand that after the receipt of the telegram, Exhibit No. 1, dated December 18, 1918, all within the year 1918, he endeavored to secure his company through Jouravleff's interests in the Baltimore tungsten smelting plant, and was informed by Hardy, who claimed to be acting under power of attorney from Jouravleff and who was Jouravleff's agent in the dealings with the Electric Reduction Company, that the stock was up as collateral and not in Jouravleff's possession, and could not be delivered—the stock in the Baltimore Tungsten Smelting Company—and that the only interest that Jouravleff had in that company was stock. This for the purpose of showing the effort made by the company

50 during the year 1918, to protect itself from loss; that it never did get the stock or get any other property.

Mr. BLAISDELL. This offer is objected to as immaterial, incompetent, and irrelevant, and as not tending to prove or disprove any issues in this case. Further, the testimony we think is necessarily hearsay, to a large extent, and would be in the nature of self-serving facts, and could not affect or change the facts in issue, and that whether or not the plaintiff obtained or attempted to obtain the capital stock in question as security for Jouravleff's debt, is entirely immaterial, irrelevant, and incompetent, and can not affect any issue in this case.

Mr. RUSLANDER. It is in issue in the case because it is a distinct allegation in the plaintiff's statement of claim, which is denied by the defendant.

The COURT. The trouble with the offer as a whole is this, you are offering to show the results of the witness's investigation in the shape of reports made to him by persons of whom he inquired. Certainly, what the party may have told this witness on the subject matter of the investigation is not competent evidence. If the testimony which Mr. Hardy could give would be competent in this case, of course he should be called, in order that he may testify in court and be subjected to cross-examination by the other side. This witness might testify as to what he did personally in an effort to secure ore, or to secure a return of the advancement made, or the failure to get ore, but that is as far as the testimony of this witness
51 could properly go. The offer as a whole is objectionable, therefore, and we sustain the objection and note an exception to the plaintiff.

Order settling bill of exceptions

The plaintiff, Electric Reduction Company, complaining that sundry errors were committed in the trial of said cause, tenders the foregoing bill of exceptions to the actions and rulings of said court and prays that the same may be settled and sealed and made a part of the record, and is so accordingly done and ordered this 14th day of September, A. D. 1925.

PER CURIAM.

[SEAL.] *S.*

In United States District Court

Opinion, filed July 9, 1925

SCHOONMAKER, J.: This is an action at law to recover income and profit taxes paid by plaintiff for the year 1918. It involves an interpretation of the revenue act of 1918, sec. 234 (a), (4), and (5), which provides:

"SECTION 234 (a). That in computing the net income of a corporation subject to tax imposed by section 230, there shall be allowed as deductions:

"(4) Losses sustained during the taxable year and not compensated by insurance or otherwise.

"(5) Debts ascertained to be worthless and charged off within the taxable year."

52 The plaintiff claims, under this section, a deduction from its 1918 income of $27,205.35, advanced by it to one Jouravleff as part payment of the purchase price of certain tungsten ore which was never delivered and which sum the plaintiff was unable to recover from Jouravleff.

The plaintiff contends that this sum was a deductible loss and the Government claims that it was a bad debt which the plaintiff is not entitled to deduct because it did not charge it off on the books of the company during the year 1918.

The case was tried before the court without a jury under agreement of the parties waiving a jury trial.

From the admissions of parties and the proofs offered at the trial we find the following facts:

"1. The Electric Reduction Company, plaintiff, claims of C. G. Lewellyn, former Collector of Internal Revenue, the defendant, the sum of $7,051.55, with interest upon $867.22 thereof from March 15, 1919, and upon $2,092.41 thereof from June 15, 1919, and upon $2,045.91 thereof from September 15, 1919, and upon $2,045.91 thereof from December 15, 1919, as additional corporation income tax, which said amounts were paid to the defendant collector on the respective dates set forth.

"2. The Electric Reduction Company, the plaintiff, is a corporation duly organized, under the laws of the State of Delaware, with its principal place of business in Pittsburgh, Pennsylvania.

53 "3. C. G. Lewellyn, the defendant, at the times of payment of said tax of $7,051.55, was the collector of internal revenue for the twenty-third district in the Commonwealth of Pennsylvania.

"4. The Electric Reduction Company duly filed its income and profits tax return for the year 1918, which showed a tax liability of $8,183.63, which said tax was duly paid to C. G. Lewellyn, the then collector of internal revenue.

"5. On or about November 29, 1922, the Electric Reduction Company filed an amended income and profits tax return for the year 1918, showing a tax liability for said year of $1,132.78, and claiming a loss sustained for the year 1918 in the sum of $27,205.35, as is more particularly shown hereinafter. With said amended return it filed a claim for refund in the sum of $7,050.85, being the difference between the tax liability shown on the amended return for 1918 and the tax liability shown on the original return for 1918, which was paid. Said claim for refund was rejected by the commissioner by letter dated April 17, 1923, upon the ground that the loss was not finally and definitely determined to be a loss until 1922, and was not charged off as such until 1922.

"6. The reason alleged by the Electric Reduction Company for the filing of the claim for refund and the amended return was that it

claimed to have suffered a deductible loss of $27,205.35 in the year 1918, which was not deducted as a loss for said year 1918 in the original return filed.

"7. The transaction on which said claim of loss is based was as follows:

54 "8. The Electric Reduction Company entered into a contract with one Konstantine Jouravleff, dated July 2, 1918, and accepted July 3, 1918. Jouravleff therein agreed to deliver to the Electric Reduction Company one hundred fifty (150) tons of tungsten ore sheelite at said company's factory, Washington, Pennsylvania, in shipments of one car of 30 to 35 tons each month, beginning August, 1918, through to the end of the year; payments, $24.00 per unit. It is agreed that Exhibit 6 attached to plaintiff's statement is a true and correct copy of said contract. The Electric Reduction Company agreed to and did accept a trade acceptance for $30,000 in favor of said Jouravleff, payable in sixty days, to apply on and to be deducted from the amount which would be due Jouravleff when he made the first shipment of ore. It is agreed that Exhibit 7 attached to plaintiff's statement is a true and correct copy of said trade acceptance.

"9. Prior to the making of said contract Jouravleff was unknown to the Electric Reduction Company; he was introduced by one Charles Hardy, a broker handling ores, who, to induce the plaintiff to enter into the said contract, verbally represented that said Jouravleff was a reputable business man of unquestioned integrity and financial responsibility, and that he was in a position to deliver tungsten ore in accordance with said contract.

"10. At the time of making the contract between Jouravleff and the Electric Reduction Company, and in order to induce said company to agree to the terms thereof and to give the acceptance provided for in said contract, the said Charles Hardy, at the request of the said company, verbally undertook to keep the said com-

55 pany fully informed concerning the deliveries of tungsten ore to be made by said Jouravleff under said contract, which deliveries were to be made at a point distant from said company's place of business and its plant, and also concerning the progress said Jouravleff was making in mining and concentrating the said tungsten ore to be used in the fulfilling and performance of said contract, as well as following up and seeing to the deliveries of said tungsten ore by said Jouravleff.

"11. After the making of the contract between Jouravleff and the Electric Reduction Company, said company performed the same on its part to be performed, and executed and delivered to said Jouravleff the acceptance provided for in the contract for $30,000.

"12. The said acceptance was given to Jouravleff with the agreement that it was to cover and be deducted from the price of the first car of tungsten ore to be shipped, which car was to be shipped before the maturity of the trade acceptance on August 30, 1918; and

that if said car was not shipped and delivered as agreed, the plaintiff was at liberty to refuse to pay the said trade acceptance.

"13. The said Charles Hardy had full knowledge of the terms and conditions under which said trade acceptance was given.

"14. John MacGregor Grant, Inc., was, in 1918, a corporation organized under the laws of the State of New York, engaged in the brokerage and banking business, had its principal place of business in New York city, and was a backer and promoter of the enterprise in which Jouravleff was engaged.

56 "15. The said trade acceptance for $30,000 was made negotiable and unconditional, and was placed before maturity with John MacGregor Grant, Inc.

"16. John MacGregor Grant, Inc., with full knowledge of the facts, and with full knowledge of the fact that the said Jouravleff had not shipped or delivered, and was not able to ship or deliver any car of tungsten ore, as required by the contract between Jouravleff and the Electric Reduction Company, negotiated for the said Jouravleff the said acceptance to innocent holders, without notice, and received therefor the sum of $30,000.

"17. The Electric Reduction Company duly paid the trade acceptance of $30,000 on August 30, 1918, at maturity, to the holder thereof.

"18. Subsequent to the making of the contract between Jouravleff and the Electric Reduction Company, and before the maturity of said trade acceptance on August 30, 1918, the Electric Reduction Company, from time to time, inquired of Charles Hardy concerning the progress that the said Jouravleff was making in mining tungsten ore, and the said Hardy promised to investigate and report.

"19. The Electric Reduction Company was induced to pay said trade acceptance by receipt of a telegram from Charles Hardy, and in reliance thereon. Said telegram is as follows:

AUGUST 29, 1918.

ELECTRIC REDUCTION COMPANY,
Washington, Pa.

Reference contract Jouravleff. Shipment one car will be made today.

HARDY.

57 "The information given in said telegram was false. No car was ever shipped.

"20. The Electric Reduction Company, from time to time, made efforts to obtain from the said Jouravleff shipments of tungsten ore under the terms of the contract between them, and to obtain repayment of the said sum of $30,000.00, but no part of said contract was ever carried out by the said Jouravleff, except the said company received from Jouravleff in December, 1918, fifty-six (56) bags containing 4,468.24 pounds of sheelite concentrates (tungsten ore) of a value of $2,784.65, which amount the Electric Reduction Company applied on said trade acceptance of $30,000.

"21. The Electric Reduction Company in March, 1919, brought three suits in the Supreme Court of the County of New York, State of New York; one against Konstantine Jouravleff; one against John MacGregor Grant, Inc., and one against Charles Hardy, the broker, to recover the said sum of $27,205.35. Judgment was obtained against the said Jouravleff in 1919, in said suit against him. The said judgment proved worthless as the said Jouravleff had no assets and had disappeared. In 1921 the said suit against John MacGregor Grant, Inc., was discontinued as worthless as the defendant in that action had been adjudged bankrupt after the commencement of the suit. In the suit against Charles Hardy, the trial court, on November 23, 1922, directed a verdict against the therein plaintiff, upon the special defense of Hardy that the alleged agreement between the Electric Reduction Company and him constituted a special promise by Hardy to answer for the debt, default or miscarriage of
58 another person, and that said promise, note or memorandum was not made in writing or subscribed by Hardy, and was void under the Statute of Frauds.

"22. The Electric Reduction Company did not charge off the amount of $27,205.35 as a loss upon said trade acceptance until November, 1922, but carried the said amount of $27,205.35 on the books of the company during the year 1918, as a bills receivable item, and the item was so carried until November 29, 1922, or thereabout, when the amended tax return for the year 1918 was filed and the said amount was then charged off as a loss."

On this state of facts we find as a matter of law that the plaintiff is not entitled to recover.

The transaction involved is one of debt falling within the provisions of sec. 234 (a) (5) of the revenue act of 1918, hereinbefore quoted. Therefore, inasmuch as this debt was not ascertained to be worthless and charged off during the year 1918, the plaintiff is not entitled to the deduction claimed.

The obligation arising out of the contract between the plaintiff and Jouravleff was clearly one of debt and comes within the definition of that term under all the authorities, among which may be noted the following definition of the word "debt":

"A sum of money due by certain and express agreement."

"All that is due a man under any form of obligation or promise." (Bouvier's Law Dictionary—Rawles third revision, vol. 1, p. 786.)

59 "A sum of money due upon contract, express or implied. In a larger sense, the word means that which one person is bound to pay to another, or to perform for his benefit; a sum of money due from one person to another, whether money, goods, or services; due; all that is due under any form of obligation or promise." (Corpus Juris, vol. 17, p. 1373.)

"Any money, goods or services that one is bound to pay to another." (Idem, p. 1374, note (46 (a)).)

"In the most extensive sense of the term, everything is a debt which is of absolute obligation." (Idem, p. 1375.)

"It might be properly and safely laid down as a general rule that all obligations arising from contracts, either express or implied, either for the payment of money or the delivery of goods, create a debt on the part of the obligor." (Hunt v. Norris, 4 Mart. (La.), 517–532.)

We have under the statute, two classes of deductions (1) bad debts ascertained to be worthless and charged off during the taxable year, and (2) losses sustained and not compensated for by insurance or otherwise.

It thus clearly appears that a loss arising from a bad debt is not the character of a loss that is an allowable deduction under sec. 234 (a) (4) above, for had it been so intended there would be no necessity for specifying the two classes of allowable deductions. The plaintiff lost the money it paid Jouravleff on account of the purchase price of ore, but that loss arose out of a bed debt which to
60 be claimed as a deduction from income, must be charged off during the taxable year. This was not done. The plaintiff can not recover.

Judgment may be entered in this case in favor of defendant and due exception noted to the plaintiff.

In United States District Court

Judgment, filed July 9, 1925

Pursuant to the foregoing action of the court, judgment is hereby entered in favor of the defendant.

J. Wood Clark, *Clerk.*

61 In United States District Court

Filed September 10, 1925

And now, September 10th, 1925, comes Electric Reduction Company, plaintiff above named, the plaintiff in error, by its attorney, S. Leo Ruslander, and respectfully makes and files the following assignment of errors:

[Assignments of error omitted; printed side page 38, ante.]

73 Wherefore the said Electric Reduction Company, for the reason of the errors assigned, prays that the judgment of the United States District Court for the Western District of Pennsylvania be reversed.

S. Leo Ruslander,
Attorney for Electric Reduction Company.

74 **In United States District Court**

Stipulation re transcript of record

Filed September 14, 1925

And now, September 14, 1925, it is hereby agreed by and between counsel for plaintiff and defendant, that the following shall be printed as and constitute the record in the above cause before the United States Circuit Court of Appeals for the Third Circuit, namely:

1. Docket entries.
2. Statement of claim, omitting the exhibits attached thereto.
3. Affidavit of defence.
4. Requests for findings of fact and conclusions of law ex parte plaintiff.
5. Bill of exceptions.
6. Opinion of the court below.
7. Judgment entered.
8. Assignment of errors.
9. Stipulation for record.

S. LEO RUSLANDER,
Attorney for Plaintiff.
JOHN D. MEYER,
United States Attorney,
Attorney for Defendant.

75 [Clerk's certificate to foregoing transcript omitted in printing.]

76 [Minute entry of argument and submission Nov. 5, 1925, omitted in printing.]

77 In United States Circuit Court of Appeals for the Third Circuit

ELECTRIC REDUCTION COMPANY, PLAINTIFF IN ERROR

v.

C. G. LEWELLYN, COLLECTOR OF INTERNAL REVENUE FOR THE TWENTY-third District of the United States, defendant in error

No. 3408, October Term, 1925

In error to the District Court of the United States for the District of Pennsylvania

Opinion filed February 27, 1926

Before Buffington, Woolley, and Davis, Circuit Judges.

DAVIS, Circuit Judge: On July 2, 1918, plaintiff below, Electric Reduction Company, agreed to purchase from one Jouravleff one

hundred and fifty to one hundred and seventy-five tons of tungsten ore. Jouravleff was to ship a car of thirty to thirty-five tons each month beginning in August, 1918. The plaintiff was "to establish immediately a banker's acceptance for $30,000 in favor of the seller for 60 days to cover and to be deducted from the first car shipped. A like acceptance to be issued, *in* necessary, on each following car." On August 29, 1918, Charles Hardy, who represented Jouravleff, telegraphed the Reduction Company: "Reference contract Jouravleff shipment one car to be made to-day." The Reduction Company, relying upon the truth of the telegram, thereupon sent its trade acceptance for $30,000 to Jouravleff. The car of ore was not shipped that day nor at any other time. However, ore to the value of $2,784.65 was subsequently shipped. Jouravleff negotiated the trade acceptance to an innocent holder for value and so the plaintiff had to pay it at maturity. The plaintiff brought suit against Jouravleff and Hardy, who had guaranteed the payment, for the amount of his loss, $27,205.35, but they were financially irresponsible.
78 The litigation lasted until 1922, when the plaintiff charged off the amount on its books and amended its tax return for 1918. The Commissioner of Internal Revenue denied the right to charge off this loss for 1918 and assessed additional taxes, which were paid under protest. A return was demanded, but was refused, and thereupon this suit was brought. The case was tried by agreement before the court without a jury. Judgment was entered against the plaintiff.

The question is whether or not the so-called loss comes within subdivision (4) or (5) of section 234 (a) of the revenue act of 1918. The act provides as follows:

"SECTION 34. (a) That in computing the net income of a corporation subject to the tax imposed by section 230, there shall be allowed as deductions—

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise.

(5) Debts ascertained to be worthless and charged off within the taxable year." (40 Stat. 1057.)

If the $27,205.35 is a "loss" within the meaning of subdivision (a) (4), it may be deducted from the income of 1918, as it was actually "sustained" in that year. If it was a bad "debt" within the meaning of (a) (5), it may not be deducted from the income of that year because it was not "ascertained to be worthless and *charged off* within the taxable year" of 1918.

According to the original return the company was liable for a tax of $8,183.63. If the $27,205.35 had been allowed as a loss sustained in the year 1918, the tax for that year would have been reduced to $1,132.78.

Congress doubtless had in mind a distinction between a loss and a worthless debt. Every worthless debt is allowed as a deduction if it is ascertained to be worthless and is charged off within the taxable year. So far as allowance as a deduction is concerned, a loss and a

worthless debt amount to the same thing, if the latter is charged off in time.

Words do not always mean the same thing. "A word is not a crystal, transparent and unchanged; it is the skin of a living thought and may vary greatly in color and content according to the circumstances in which it is used." Lamar v. United States, 240 U. S. 60.

The word "*bedt*" has no fixed legal meaning as does the word
79 "contract." Alimony is sometimes said to be a debt and sometimes not a debt. The word has several recognized meanings which vary greatly according to the subject matter and language used in connection with it. Hornbeck v. State, 71 N. E. 916; McNeal v. Waco, 89 Texas 83; In re Nowell, 99 Fed. 931. Bouvier says a debt is "a sum of money due by certain and express agreement." Neither does the word "loss" have a hard and fast meaning. "Failure to keep that which one has is a loss." Foehrenbach v. German American Title and Trust Company, 217 Pa. 332. There are many kinds of loss: Money out of pocket; a judgment changing the status from solvency to insolvency. Schambs v. Fidelity & Casualty Co., 259 Fed. 55, 58. In some cases the words "loss" and "debt" are interchangeable, but in others they are not. Mercantile Credit Guarantee Co. v. Wood et al., 68 Fed. 529, 533. Again "loss" may be synonymous with "destruction"—loss or destruction of property, Hawkins v. Haines, 71 Ga. 40; Richmond & E. R. Co., 88 Ga. 805.

Some definitions of "loss" cover the transaction in question. The plaintiff failed to keep what it had and parted with it through fraud and misrepresentation. On the other hand there are definitions of "debt" which do not include this transaction. The $27,205.35 was not due the plaintiff by a "certain and express agreement." At no time did Jouravleff by a "certain and express agreement" promise to pay anything. He promised to send ore, not to pay money, and because he did not keep that promise, the plaintiff sustained a loss. Some losses, such as the loss of a building by fire, may be "compensated for" by insurance. Others, such as the loss of a bad account, may be "compensated for" "otherwise," by the guaranty of a factor or in some other way. The plaintiff did not lose the entire $30,000, but it did lose $27,205.35 which was not compensated for by insurance, or otherwise.

The loss was sustained in 1918, the taxable year. In that year the money was paid and was never recovered. That the plaintiff was engaged in litigation three or four years in an effort to recover it and did not charge it off until 1922, do not change the fact nor time of the loss. The entry of the charge-off was a mere bookkeeping transaction. It neither created nor changed any fact. It
80 simply recorded the fact which had existed for four years. Baldwin Locomotive Works v. McCoach, 221 Fed. 59, 60; Doyle, Collector, v. Mitchell Brothers Co., 247 U. S. 179.

In the construction of a taxing statute doubts should be resolved against the Government and in favor of the taxpayer. American Net & Twin Co. v. Worthington, 141 U. S. 468, 474; Benziger v.

United States, 192 U. S. 38, 55; Gould v. Gould, 245 U. S. 151. It is not clear to us that the term "losses" in subdivision (a) (4) of section 234 of the act does not include the loss of the $27,205.35. Therefore the judgment of the District Court is reversed and a new trial granted.

81 In United States Circuit Court of Appeals for the Third Circuit

[Title omitted.]

Judgment, filed Feb. 27, 1926

In error to the District Court of the United States for the Western District of Pennsylvania.

This cause came on to be heard on the transcript of record from the District Court of the United States for the Western District of Pennsylvania, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said district court in this cause be, and the same is hereby, reversed and a new trial granted.

J. WARREN DAVIS,
Circuit Judge.

PHILADELPHIA, *February 27, 1926.*

[File indorsement omitted.]

82 In United States Circuit Court of Appeals

Mandate, filed March 29, 1926

The President of the United States of America, to the honorable the judges of the District Court of the United States for the Western District of Pennsylvania, greeting:

Whereas lately in the District Court of the United States for the Western District of Pennsylvania, before you or some of you, in a cause between Electric Reduction Company (plaintiff below), plaintiff in error, and C. G. Lewellyn, collector of internal revenue (defendant below), defendant in error, a judgment was entered in the said district court on the ninth day of July, 1925, which judgment is of record in the office of the clerk of the said district court, to which reference is hereby made, and the same is hereby expressly
83 made a part hereof, as by the inspection of the transcript of the record of the said District Court, which was brought into the United States Circuit Court of Appeals for the Third Circuit by virtue of a writ of error agreeably to the act of Congress, in such case made and provided, more fully and at large appears.

84 And whereas, in the term of October, in the year of our Lord one thousand nine hundred and twenty-five, the

said cause came on to be heard before the said United States Circuit Court of Appeals on the said transcript of record and was argued by counsel:

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said district court in this cause be, and the same is hereby, reversed and a new trial granted.

PHILADELPHIA, *February 27, 1926.*

85 You, therefore, are hereby commanded that such execution and further proceeding be had in said cause, as according to right and justice and the laws of the United States, ought to be had, the said writ of error notwithstanding.

Witness, the Honorable William Howard Taft, Chief Justice of the Supreme Court of the United States, at Philadelphia, the twenty-ninth day of March, in the year of our Lord one thousand nine hundred and twenty-six.

SAUNDERS LEWIS, JR.,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

[File indorsement omitted.]

86 [Clerk's certificate to foregoing transcript omitted in printing.]

87 In Supreme Court of the United States

Order allowing certiorari, filed October 11, 1926

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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In the Supreme Court of the United States

OCTOBER TERM, 1925

No. ——

C. G. LEWELLYN, COLLECTOR OF INTERNAL REVENUE for the Twenty-third District of the United States in the Western District of Pennsylvania, Petitioner

v.

ELECTRIC REDUCTION COMPANY, A CORPORATION Organized and existing under the Laws of the State of Delaware

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of C. G. Lewellyn, Collector of Internal Revenue for the Twenty-third Pennsylvania District, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit (R. 79) entered in the above case February 27, 1926, reversing the judgment of the United States District Court for the Western District of Pennsylvania (R. 60).

QUESTIONS PRESENTED

This case presents another phase of the same question involved in *United States* v. *S. S. White Dental Company,* No. 957, on the docket of this Court for the present term, in which, upon the request of the Government, a writ of certiorari was granted on April 19, 1926.

The questions are:

1. Is respondent, under Section 234 (a) (4) of the Revenue Act of 1918, entitled to deduct in computing net income for the year 1918, as a *loss* " sustained during the taxable year," the sum of $27,205.35, representing an unpaid balance of money advanced for the purchase of ore, or should the deduction be taken for the year 1922?

2. Is respondent, under Section 234 (a) (5) of the Revenue Act of 1918, entitled to deduct in the year 1918 said sum of $27,205.35 as a *debt* " ascertained to be worthless and charged off within the taxable year," or should the deduction be taken for the year 1922?

STATEMENT

On July 3, 1918, respondent, a Delaware corporation, entered into a written contract with one Konstantine Jouravleff by virtue of which the latter agreed to deliver from 150 to 175 tons of tungsten ore at respondent's factory at Washington, Pennsylvania. Delivery was to be made in monthly carload shipments of from 30 to 35 tons, beginning with the month of August, 1918. Under the terms of the contract it was agreed that respondent should

immediately accept a draft for $30,000 in favor of Jouravleff to cover and be deducted from the purchase price of the first car of ore shipped. Like drafts were to be accepted, if necessary, on subsequent shipments. (R. 34, 52, 54.)

Jouravleff was unknown to respondent. The contract with him had been entered into upon the representations of one Charles Hardy, a broker, that Jouravleff was a reputable business man, financially responsible and able to carry out the terms of the contract. A draft was drawn by Jouravleff for $30,000, dated July 1, 1918, upon which respondent indorsed an acceptance. (R. 35, 54.) Jouravleff immediately negotiated this draft through John MacGregor Grant, Inc., bankers and brokers of New York, to an innocent holder for value. (R. 56.) This firm of bankers were backers of Jouravleff and had knowledge of the terms of the contract and the conditions under which the draft was issued. (R. 55–56.) Hardy, the broker, had agreed to keep respondent informed concerning the progress made by Jouravleff in mining and shipping the ore. (R. 54–55.) On August 29, 1918, he telegraphed respondent as follows: " Reference contract Jouravleff. Shipment one car will be made to-day." In reliance upon this information, on August 30, 1918, respondent paid to the holder the full amount of the draft. (R. 56.) No carload of ore was shipped then or at any other time. All the ore ever received by respondent from Jouravleff

was 56 bags containing some 4,500 pounds, of the value of $2,794.65, received in December, 1918. This sum was credited to the account of $30,000, leaving a balance of $27,205.35 due respondent from Jouravleff. (R. 57.)

In March, 1919, respondent instituted three separate suits in the Supreme Court of the County of New York, to recover said sum of $27,205.35—one against Jouravleff, one against John MacGregor Grant, Inc., and the other against Charles Hardy. The judgment obtained against Jouravleff in 1919 proved worthless, as he had disappeared, leaving no property. The suit against John MacGregor Grant, Inc., was discontinued in 1921 as worthless, the defendant having been adjudged bankrupt. On November 23, 1922, the New York court directed a verdict in Hardy's favor, on the ground that the alleged agreement between him and respondent constituted a specific promise to answer for the debt, default, or miscarriage of another person and, not having been reduced to writing, was void under the Statute of Frauds. (R. 57–58.)

Respondent did not charge off the sum of $27,205.35 in 1918, when Jouravleff failed to perform his obligation, but continued to carry it on its books under " Bills Receivable " (R. 58), and for that year it filed an income and profits tax return showing a tax liability of $8,183.63, which amount it paid. Upon the termination in 1922 of the above-mentioned litigation, however, the company filed an amended return for 1918, in which the loss was

claimed as a deduction, leaving a total liability for 1918 amounting to $1,132.78. With this amended return a claim was filed for a refund of $7,050.85, being the difference between the tax liability claimed in the amended return and the amount paid upon the original return. (R. 53.) The Commissioner of Internal Revenue rejected this claim for refund; whereupon this action was brought in the United States District Court for the Western District of Pennsylvania for recovery. (R. 5.)

The District Court (R. 51–60; 8 F. (2d) 91) held that the sum of $27,205.35 represented a "bad debt" rather than a " loss " and that therefore under the provisions of Section 234 (a) (5) of the Revenue Act of 1918 it could only be deducted in the year actually charged off the books, which in this case was 1922. Upon writ of error the Circuit Court of Appeals for the Third Circuit reversed the judgment of the District Court, holding that the amount was not a " bad debt," but a " loss "; that therefore the provisions of Section 234 (a) (4) of the Revenue Act of 1918 applied and that the loss was *sustained* in the taxable year 1918. (R. 76–79; not yet reported.)

It is the position of the Government that the sum of $27,205.35 represented a debt and under Section 234 (a) (5) was deductible in 1922, the year in which it was admittedly charged off the books. It is the further contention of the Government that even if said sum represents a loss, as held by the

Circuit Court of Appeals, as such it could only be deducted under Section 234 (a) (4) when evidenced by a closed and completed transaction, which in this case would not be until the termination of the litigation in 1922.

STATUTE INVOLVED

The Revenue Act of 1918 (Ch. 18, 40 Stat. 1057, 1077–1078) provides:

> Section 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;
>
> (5) Debts ascertained to be worthless and charged off within the taxable year.

REASONS FOR GRANTING THE WRIT

1. The Circuit Court of Appeals erred in holding that the sum of $27,205.35 represented a "loss" instead of a "bad debt" and that under Section 234 (a) (4) of the Revenue Act of 1918 it was sustained in the year 1918.

2. While each case presents a different state of facts, the principle involved in the instant case is the same as that involved in the case of *United States* v. *S. S. White Dental Company,* now pending before this Court on a writ of certiorari granted on April 19, 1926. In the *S. S. White Dental Company case* the taxpayer claimed the right to deduct

as a loss the value of the property of a subsidiary which was sequestered by Germany during the war before it had been ascertained whether or not compensation therefor would be made by Germany. In the instant case the right is claimed to deduct a so-called "loss" in the year 1918, at which time litigation for its recovery had not terminated.

The principle involved in this and the *S. S. White Dental Company case* is one of great importance to the Bureau of Internal Revenue in the administration of the taxing statutes. The Treasury Department has always provided in its regulations, which it has consistently carried out, that no loss could be deducted unless it was actually sustained within the taxable year as evidenced by a closed and completed transaction. The amount involved in this class of cases is very large. It is desirable, therefore, that a writ of certiorari issue in this case with the expectation that decisions on varying facts may result in the establishment of a settled rule for the guidance of the courts and the Treasury Department.

Wherefore it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Third Circuit should be granted.

WILLIAM D. MITCHELL,
Solicitor General.

MAY, 1926.

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PETITIONER'S BRIEF

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In the Supreme Court of the United States

OCTOBER TERM, 1927

No. 71

C. G. LEWELLYN, COLLECTOR OF INTERNAL REVENUE for the Twenty-third District of the United States, etc., petitioner

v.

ELECTRIC REDUCTION COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the District Court (R. 27–32) is reported in 8 F. (2d) 91. The opinion of the Circuit Court of Appeals (R. 33–36) is reported in 11 F. (2d) 493.

JURISDICTION

The judgment to be reviewed was entered February 27, 1926. (R. 36.) Petition for a writ of certiorari was filed May 24, 1926, and was granted by this Court October 11, 1926, under the Judicial Code, Section 240(a), Act of February 13, 1925.

THE QUESTION PRESENTED

The question presented is whether the respondent was entitled to deduct from gross income for 1918, as a loss sustained in that year, the sum of $27,205.35, representing an amount paid out on a trade acceptance as an advance on the purchase price of ore which was never delivered, or whether the deduction should be taken in 1922, when efforts to recover ended and the item was charged off the taxpayer's books.

It is necessary to determine whether the item in question should be classed as a debt admittedly not deductible from 1918 income because not "ascertained to be worthless and charged off within the taxable year," or as not a debt but a loss, and whether it resulted from a transaction closed and completed during 1918.

STATUTE INVOLVED

The Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1077–1078) provides:

> SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;
>
> (5) Debts ascertained to be worthless and charged off within the taxable year.

Article 141 of Regulations 45, relating to the income-tax provisions of the Revenue Act of 1918, and subsequent revisions, in dealing with the subject of deductible losses, has consistently provided as follows:

> They must usually be evidenced by closed and completed transactions.

STATEMENT

This is one of a group of three cases brought here with a view to working out some principle or rule to settle the questions constantly arising whether deductible items are debts or losses and when they are deductible.

The case was tried on a stipulation of facts and admissions in the pleadings, which were followed by findings of fact. (R. 28.)

On July 3, 1918, respondent, a Delaware corporation, entered into a written contract with one Konstantine Jouravleff by virtue of which the latter agreed to deliver from 150 to 175 tons of tungsten ore at respondent's factory at Washington, Pennsylvania. Delivery was to be made in monthly carload shipments of from 30 to 35 tons, beginning with the month of August, 1918.

The contract (R. 19, 29) provided:

> Buyers to establish immediately a banker's acceptance for $30,000 in favor of seller for 60 days to cover and to be deducted from first car shipped. A like acceptance to be issued, if necessary, on each following car.

Jouravleff was unknown to respondent. The contract with him had been entered into upon the representations of one Charles Hardy, a broker, that Jouravleff was a reputable business man, financially responsible and able to carry out the terms of the contract. A draft was drawn by Jouravleff for $30,000, dated July 1, 1918, upon which respondent indorsed an acceptance. (R. 19, 29.)

This draft was in the following form (R. 19):

> WASHINGTON, PENNA., *July 1, 1918.*
>
> $30,000.00.
>
> Sixty days after date ———— pay to the order of K. Jouravleff thirty thousand dollars and no/100 dollars. The obligation of the acceptor hereof arises out of the purchase of goods from the drawer.
>
> Value received and charge the same to account of
>
> K. JOURAVLEFF.

The findings state (R. 29):

> The said acceptance was given to Jouravleff with the agreement that it was to cover and be deducted from the price of the first car of tungsten ore to be shipped, which car was to be shipped before the maturity of the trade acceptance on August 30, 1918; and that if said car was not shipped and delivered as agreed, the plaintiff was at liberty to refuse to pay the said trade acceptance.

Jouravleff immediately negotiated this draft through John MacGregor Grant, Inc., bankers and brokers of New York, to an innocent holder for

value. This firm of bankers were backers of Jouravleff and had knowledge of the terms of the contract and the conditions under which the draft was issued. (R. 30.) Hardy, the broker, had verbally agreed to keep respondent informed concerning the progress made by Jouravleff in mining and shipping the ore. (R. 29.) On August 29, 1918, he telegraphed respondent as follows (R. 30):

> Reference contract Jouravleff. Shipment one car will be made to-day.

The findings state that the respondent was induced to pay the trade acceptance in reliance on the above telegram from Hardy (R. 30), but, as the findings elsewhere show that the trade acceptance had passed into the hands of a bona fide holder (R. 30), the telegram may not have been the sole reason for payment.

No carload of ore was shipped then or at any other time. All the ore ever received by respondent from Jouravleff was 56 bags containing some 4,500 pounds, of the value of $2,794.65, received in December, 1918. This sum was credited to the account of $30,000, leaving a balance of $27,205.35 due respondent from Jouravleff. (R. 30.)

In March, 1919, respondent instituted three separate suits in the Supreme Court of the County of New York, to recover said sum of $27,205.35—one against Jouravleff, one against John MacGregor Grant, Inc., and the other against Charles Hardy. The judgment obtained against Jouravleff in 1919

proved worthless, as he had disappeared, leaving no property. The suit against John MacGregor Grant, Inc., was discontinued in 1921 as useless, the defendant having been adjudged bankrupt. On November 23, 1922, the New York court directed a verdict in Hardy's favor, on the ground that the alleged agreement between him and respondent constituted a specific promise to answer for the debt, default, or miscarriage of another person and, not having been reduced to writing, was void under the Statute of Frauds. (R. 31.)

Respondent did not charge off the sum of $27,205.35 in 1918, when Jouravleff failed to perform his obligation, but continued to carry it on its books under "Bills Receivable" (R. 31), and for that year it filed an income and profits tax return showing a tax liability of $8,183.63, which amount it paid. Upon the termination in 1922 of the above-mentioned litigation, however, the company filed an amended return for 1918, in which the loss was claimed as a deduction, leaving a total liability for 1918 amounting to $1,132.78. With this amended return a claim was filed for a refund of $7,050.85, being the difference between the tax liability claimed in the amended return and the amount paid upon the original return. (R. 28.) The Commissioner of Internal Revenue rejected this claim for refund (R. 28); whereupon this action was brought in the United States District Court for the Western District of Pennsylvania for recovery. (R. 2.)

The District Court (R. 27–32) held that the sum of $27,205.35 represented a "bad debt" rather than a "loss," and that therefore under the provisions of Section 234 (a) (5) of the Revenue Act of 1918 it could only be deducted in the year actually charged off the books, which in this case was 1922. Upon writ of error the Circuit Court of Appeals for the Third Circuit reversed the judgment of the District Court, holding that the amount was not a "bad debt" but a "loss"; that therefore the provisions of Section 234 (a) (4) of the Revenue Act of 1918 applied and that the loss was *sustained* in the taxable year 1918. (R. 33–36.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred in holding that the item in question represented a loss within the provisions of Section 234 (a) (4) of the Revenue Act of 1918, instead of a debt within the provisions of Section 234 (a) (5).

The Circuit Court of Appeals, in treating the item as a loss rather than a debt, erred in holding that the loss was sustained in the taxable year 1918.

SUMMARY OF ARGUMENT

The trade acceptance by the respondent and its payment at maturity gave rise to a debt in the respondent's favor, to be set off against its obligation to arise on shipment of the ore. It was so treated by the taxpayer and entered on its books as an Account Receivable. Treating the item as a debt,

it is governed by subdivision (5) of Section 234 (a), which, in dealing with debts, allows deductions only of—

> Debts ascertained to be worthless and charged off within the taxable year.

The debt in the instant case was admittedly not charged off until 1922.

If the item be held to constitute a loss instead of a bad debt, still the loss should not be deducted from 1918 income for the reason that it was not sustained during that year, as the transaction and ascertainment of the loss was not closed or completed until later.

ARGUMENT

I

THE TRANSACTIONS BETWEEN RESPONDENT AND JOURAVLEFF CREATED THE RELATION OF CREDITOR AND DEBTOR

The giving and the payment of the trade acceptance, while directly related to the contract for purchase and delivery of ore, was in fact treated by the parties as an independent transaction. It was understood and treated by them as creating the relation of debtor and creditor. The debt arose in favor of the respondent to be set off *pro tanto* against the debt to arise in favor of Jouravleff on shipment of ore. It was entered by the respondent on its books as an Account Receivable. The transaction therefore differs in some respects from what

it would have been if it had taken the form of a payment by the respondent to Jouravleff as a partial payment on purchase price of ore to be delivered. It was really a loan of credit, which ripened into a debt in favor of the respondent when it paid the draft. Under the circumstances, the item partakes more of the nature of a debt, which is only deductible when it is both ascertained to be worthless and charged off within the taxable year, than it does of a loss, within the other subdivision, not compensated for by insurance or otherwise.

If the item in question is to be treated as a bad debt instead of a loss sustained, it is clear that it was not deductible for 1918, because bad debts to be deductible must not only be ascertained to be worthless but must be "charged off within the taxable year," and this item was not charged off until the effort to recover it terminated in 1922.

Of course, the failure to collect any debt results in a loss to the creditor, but in the various Revenue Acts Congress sought to place losses from bad debts in a classification separate and apart from the general run of losses in respect of the matter of deductions from income. It is generally a simple matter to determine when a loss is sustained by fire, flood, tornado, or other destruction of property, or by a drop in the value, followed by subsequent sales, but it is difficult sometimes to ascertain when a debt becomes worthless. It may have been worthless at the time credit was extended and

the debt created. Congress, consequently, put the matter of deducting bad debts very largely in the hands of the taxpayer himself by providing that a debt may be deducted from income in the year in which the taxpayer ascertains the debt to be worthless and charges it off his books. In this case the taxpayer should not be allowed to complain that its own treatment of this item was accepted by the Bureau of Internal Revenue.

But treating the item as properly coming under the head of loss sustained instead of a debt ascertained to be worthless, it nevertheless was not deductible for 1918.

In the application of the provision for deduction of losses sustained within the taxable year the Treasury Department has consistently provided, by regulation, that a loss is not sustained until the transaction is closed and completed. In that sense this loss was not sustained in 1918 merely because Jouravleff failed to ship ore.

As late as 1919 the respondent instituted a suit against Jouravleff to recover $27,205.35, the balance owing on account of the trade acceptance after crediting him with the contract price on ore shipped. It does not appear that Jouravleff's lack of responsibility was definitely ascertained until after the judgment was entered in that case. The findings state (R. 31):

> Judgment was obtained against the said Jouravleff in 1919, in said suit against him.

> The said judgment proved worthless as the said Jouravleff had no assets and had disappeared.

There was also a claim against John MacGregor Grant, Inc., for negotiating the draft to a bona fide holder, with knowledge that no ore had been shipped. This claim was considered substantial enough to justify the respondent in suing John MacGregor Grant, Inc., and the suit was not discontinued until 1921, as the result of the adjudication of the defendant as a bankrupt after the commencement of the suit. (R. 31.) There was also a claim by respondent against Hardy, made the basis of a suit against him commenced in 1919, as a guarantor of the obligation of Jouravleff, and it was not until 1922, at the trial of this case, that the claim was disposed of by a judgment against respondent on the ground that Hardy's obligation was not in writing and was void under the Statute of Frauds. It was following the outcome of the final suit against Hardy, in November, 1922, that the item was charged off its books by the respondent. If there is any effect in a case of this kind to be given to the regulation that a loss is not sustained until there is a closed and completed transaction, this was not a closed and completed transaction in 1918.

During the period of periodically increasing income-tax rates taxpayers were quite content to accept this regulation and its application by the Treasury Department, resulting, as it did, in delay-

ing deductions until the years of higher tax rates. After the tide turned and income-tax rates underwent periodical reduction, we find taxpayers insisting that deductions shall relate back to earlier years of high tax rates. Long after the event, and after the transaction has been completely wound up and closed, it is easy to look back and say the loss occurred at the time of the original transaction, but such an application of the statute would result in the frequent and continuous readjustment of income-tax returns for past years, and a construction of the law should not be adopted which produces that result if it may be properly avoided.

This case is one of three brought to this Court presenting different phases of this subject. Each case depends largely on its own facts, and the justification for bringing here this and the other cases referred to is the expectation that decisions on the varying facts of a number of cases may point out principles to guide the Treasury Department in dealing with this troublesome problem.

One of the cases, *United States* v. *S. S. White Dental Company,* decided May 16, 1927, dealt with the question whether an American taxpayer suffered a loss in 1918 through the seizure in that year of property in Germany, the seizure having been made by the German Government under its power to sequester and confiscate the private property of alien enemies found within its jurisdiction at the

outbreak of the war. The Court there held against the United States, the ground of the decision being that title to the property was gone at the seizure, leaving only a moral and not a legal obligation on the part of the German Government to pay it and only a chance of reimbursement as a matter—

> either of grace to the vanquished or exaction by the victor.

In the present case there was a definite legal obligation owing to the taxpayer, with guaranties supposed to be valuable, and it does not appear that the inability to enforce this obligation was established until after 1918.

The other case, *Malleable Iron Range Co.* v. *United States,* raised the question whether a judgment for damages for infringement of a patent became a deductible item in the year in which judgment for infringement was rendered or, appeal having been taken, in the year in which the judgment was affirmed by the Circuit Court of Appeals, or in the year in which the infringement appears to have occurred. That case was remanded to the Court of Claims for further findings.

CONCLUSION

The circumstances of this case justify the conclusion of the District Court that the item here in question should be treated as a debt ascertained to be worthless and not deductible until charged off its books by the taxpayer, but, on the theory that

the item should be treated as a loss instead of a bad debt, there was ground for the conclusion of the Commissioner of Internal Revenue that the transaction was not closed until after 1918.

Respectfully submitted.

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OCTOBER, 1927.

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